LOS ANGELES BAR BULLETIN

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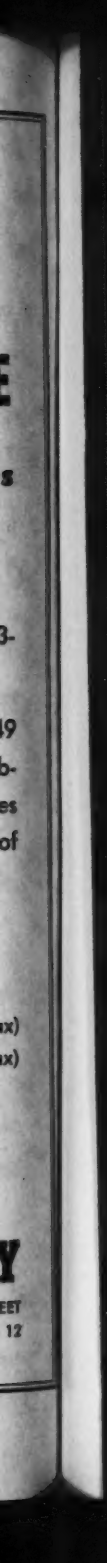

Los Angeles
BAR BULLETIN

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Vol. 26 FEBRUARY, 1951 No. 6

PRESIDENT'S PAGE

Dana Latham

WITHIN a few days after this issue of the BULLETIN reaches you, I will have been succeeded by my good friend and yours, Herman F. Selvin.

What follows is not intended to constitute a report of the Association's activities during the past year. Most of our members are in general familiar with our activities and accomplishments.

I think it will be in order, however, to refer briefly to a few matters affecting the Association.

It gives me pleasure to report that during the year 1950 our membership increased from 2453 to 2620, the highest point in our history. In this connection, I might point out that in my judgment our membership is still too low in terms of a percentage of the total number of lawyers practicing in Los Angeles. On the other hand, I am of the opinion that special membership drives are of little permanent value. The Association must convince the lawyers of this City and County that membership in the Los Angeles Bar Association is worthwhile. In other words, the lawyers must want to join us.

I feel that during the past year the Association has done much to increase its stature and influence in the community and among the members of the legal profession. The Association has evidenced a willingness to "stand up and be counted" where matters of public interest are concerned. This course I know will be continued under my worthy successor.

The Association has undertaken two projects which are and will continue to be close to my heart:

(1) A program which contemplates a substantial expansion of our Lawyer Reference Service. This program

is and will be of far-reaching importance and I know it will be continued in the years to come.

(2) A survey has been made and the membership has, by an overwhelming vote of those responding, approved a study of a proposal to expand the Association's quarters and facilities.

It was my hope that before my term of office expired we could present a definite and concrete plan to the membership for final approval. The unsettled state of the world and of the nation has made this impossible. You may be assured, however, that the study and the proposed program is continuing and there is every expectation that although some slight delay may be necessary our goal will ultimately be accomplished.

If space permitted I might refer to many other matters of vital interest to our Association and our profession which have been considered by our trustees during the past year. I know, however, that you will hear of them through the incoming administration.

The greatest honor which has come to me has been the privilege of serving as the President of the Los Angeles Bar Association during the past year. Some of the things that I hoped could be accomplished have come to pass. Too many of my dreams have failed of achievement. I can only say that I hope to continue to serve the Association in whatever capacity I may be of value.

In particular, I want to express my deep and heartfelt appreciation for the complete assistance and cooperation which I have received from your trustees, my fellow officers, our committee chairmen and members, and the Bar as a whole. I am especially anxious to thank our Executive Secretary and his loyal and able staff for their untiring efforts. To work with all these people has been a privilege which I wish could come to every member of our Bar.

Finally, may I exhort you to give the same fine assistance and cooperation to your new officers and trustees that you have given to the administration just ended. Under Mr. Selvin I am sure the Association will go forward and achieve new and greater goals.

DANA LATHAM.

SOME PROBLEMS WITH COMMUNITY OIL AND GAS LEASES IN CALIFORNIA

By Roy P. Dolley* and Adolph H. Levy**

Roy P. Dolley

Adolph H. Levy

A COMMUNITY oil and gas lease is a lease under which several landowners lease their respective parcels to form one tract for development by the lessee, with the sole and exclusive right in the lessee to drill for and produce oil upon any part of it.

The distinguishing feature of this type of oil and gas lease, according to Tanner v. Title Insurance & Trust Co., 20 Cal. (2d) 814, 818, "is that each owner shares proportionately in the royalties irrespective of the lot or lots upon which oil is discovered."

Community oil and gas leases have come into more common usage in California only in recent years. Their use arises principally out of the necessity or desirability of combining small parcels of separately owned land—generally of less than one acre in area—into larger units for oil drilling and development.

State well-spacing statutes have been enacted to prevent drilling on a parcel of land smaller than one acre. In addition, many municipalities have enacted ordinances which also restrict the drilling of wells on small parcels of land within city limits, particularly in residential or business districts.

In potential oil areas in which the lands have been subdivided into small parcels, oil companies generally undertake to lease such parcels under a community lease in order to minimize uneconomic

*Roy P. Dolley is a graduate of the Law School of the University of Southern California and was admitted to the California Bar in 1924. He devotes the larger part of his practice to the field of oil and gas and has appeared as counsel in a number of cases which have assisted in developing oil and gas royalty law. Mr. Dolley is a member of the firm of Dolley, Knight, Woods & Hightower.

**Adolph H. Levy is a graduate of Stanford Law School and was admitted to the California Bar in 1931. From 1941-46, he was a member of the staff of the Petroleum Administrator in Washington, D. C. Mr. Levy is a partner in the firm of Mindlin & Levy. Together with Mr. Dolley, Mr. Levy is the author of the article "Development of Oil Royalty Law in California" which appeared in the July, 1950, issue of the LOS ANGELES BAR BULLETIN.

competitive drilling. This is because one well will ordinarily drain as much or more oil from a number of acres of land as will two or more wells, and also because oil exploration and development are both speculative and expensive.

This type of oil and gas lease presents a number of interesting problems which are not present in the usual oil and gas lease.

In California our Supreme Court held in Tanner v. Title Insurance & Trust Co., 20 Cal. (2d) 814 (1942), that by executing a community lease each landowner conveyed to his colessors a percentage interest in all oil produced from his land by the lessee during the continuance of the lease. The court stated that the consideration for that transfer was the similar mutual assignments of the other lessors; that a royalty interest was thus transferred by each landowner to his colessors, which royalty interest is an incorporeal hereditament in gross; that the grantee's interest in the oil produced upon the property of one of the colessors is entirely separate and distinct from the royalty interest retained by him in oil which might be produced from his own premises; and that although the royalty reserved by a lessor in oil produced from his own land passes to a grantee of the fee as an incident of the conveyance, the incorporeal hereditament owned by the grantor in oil produced from the land of the colessors, existing in gross, obviously does not follow the conveyance of the lessor's land, but can only be conveyed by a specific transfer of that interest.

The Tanner case is the law in California as to the nature of the royalty interest created by a community oil and gas lease. However, although it is the law and appears most plausible, we are concerned as to whether it is sound law.

Does any landowner, by becoming a party to a community oil and gas lease, intend to convey or convey to his colessors any interest in his land, or intend to receive or receive from his colessors any interest in their respective lands?

Are two kinds of royalty interest created in each parcel of land, as stated in the Tanner case:—(1) a royalty interest retained by a lessor in oil which might be produced from his own premises, which interest would pass to a grantee of the fee as an incident of the conveyance thereof; and (2) a royalty interest received by each lessor from each of his colessors in oil which might be produced from their premises, which interests exist in

gross and thus would not follow the conveyance of the lessor's land, but could only be conveyed by a specific transfer of those interests?

In the event of a surrender of the entire lease by the lessee, do the royalty interests in gross continue in existence as to each parcel of land until each landowner has executed reconveyances of such interests to every other landowner?

Another problem not present in the usual oil and gas lease relates to the exercise of the right of forfeiture by the lessors upon a breach of the lease by the lessee. In Moon v. Marker, 26 Cal. App. (2d) 33 (1938), the District Court of Appeal stated that if separate owners of different parcels of land join in one community lease of their several properties for the purpose of developing oil and gas thereon, they must all join in an action to cancel the lease for any alleged breach thereof which renders a forfeiture of the instrument optional; the right to declare a forfeiture cannot be exercised by less than all; and the waiver of a breach by one joint lessor may be deemed to be a *waiver by all*. (See also Bayside Land Co. v. Dabney, 90 Cal. App. 122; Jones v. Pier, 124 Cal. App. 444, and Metzler & Co. v. Stevenson, 217 Cal. 236.)

Should the same rule of law which requires joint action to declare a forfeiture by all owners of undivided interests in one parcel of land apply where the owners are not owners of undivided interests in one parcel of land but are separate owners of different parcels of land?

Does not the owner of one parcel have the right to declare a forfeiture of the community lease as to his parcel for breach of the lease by lessee, or must his land continue under the lease, even though the lease is in default, until all of the owners of all of the lands in the lease join in the declaration of a forfeiture of the entire lease?

These are difficult questions to answer. They are also important questions, for they involve substantial property interests.

A not uncommon community lease may embrace twenty acres of land or more and include as many as a hundred separately owned town-lots, a considerable number of which separate lots may each be owned by two or more joint tenants or tenants in common. The owners may be scattered all over the country. As the lease continues in existence and time passes, the fee interest

in some of the lots may be transferred, as by sale, inheritance or foreclosure.

The rules enounced in the Tanner and Moon cases, above mentioned, lead to some strange results.

Apparently, if a well is producing oil on A's land, and A sells his land to B, B acquires A's royalty interest in the oil produced on that land.

If there is a well producing oil on some other parcel of the lease, under a sale by A to B the latter does not acquire A's royalty interest in the oil produced on such other land; A retains this interest. In Friedrich v. Roland, 95 Cal. App. (2d) 543 (1950), the District Court of Appeal, upon the authority of the Tanner case, held just this way.

If a well is producing oil on A's land, and another well is also producing oil on some other parcel of the lease, under a sale by A to B the latter acquires A's royalty interest in oil produced from A's land but A retains his royalty interest in the oil produced on such other land.

If the lessee surrenders the entire lease and the lessee's interest in the land is thus terminated, the royalty interests may nevertheless be held to continue in each owner in every parcel until reconveyances from all others are secured by each owner. If reconveyances are not so secured by A, and a well is thereafter drilled and produces oil on A's land, all other former colessors may still be entitled to their royalty share of this oil.

If the lessee fails to perform his obligations under the community lease and the lease requires the giving of a notice of forfeiture in order to terminate the lease, the lease cannot be terminated as to any parcel until all of the owners of all of the parcels join in such notice. This requirement may well be an unsurmountable obstacle, as where a hundred or more colessors are signatory to the lease and they or their successors in interest are spread all over the county, and cannot all be located, or where one colessor out of a hundred or more waives the lessee's breach. Under this requirement, it is possible for the lessee to breach every obligation he undertook by the lease, sit on the land and do nothing except ignore his community lessors and nevertheless continue to hold all of the land indefinitely.

With regard to the Tanner case as to the nature of the royalty interest created under a community oil lease, we suggest that:

(Continued on page 237)

RESOLUTION:

BOARD OF TRUSTEES

Los Angeles Bar Association Commemorating Ewell D. Moore.

Adopted January 16, 1951

In the passing of EWELL D. MOORE on January 1, 1951, the community in which he lived and worked lost an honored and upright citizen, the legal profession a distinguished member, and the Los Angeles Bar Association a valued and efficient worker.

In his early years he studied telegraphy and soon became recognized as one of the best operators in the nation. He then entered the service of the Associated Press as a correspondent, and rapidly advanced in this new vocation, becoming successively Manager of the Los Angeles Office, Western Division Manager, and Manager of the New York Office.

His thoughts then turned to the profession of law, which claimed his talents during the remainder of his life. He studied law at Columbia University, graduating at the head of his class, and, coming West again to California, was admitted to the bar and practiced first in San Francisco and later in Los Angeles which was the scene of his labors until his death.

He soon became a member of the Los Angeles Bar Association and at once took an active interest in its affairs. He was a Trustee of the Association from 1936 until his resignation in 1948, was treasurer for ten years, and for a time secretary. His early training in journalism with the Associated Press qualified him peculiarly to play a leading part in the development of the LOS ANGELES BAR BULLETIN, and for more than twenty years he was a member of the BULLETIN Committee and for some years its Chairman. Much credit is due him for the leading position which the LOS ANGELES BAR BULLETIN attained among Bar Association publications during the long period in which he gave his time and talents so freely to its publication. He was always ready and willing to labor for the good of his profession, and this qualification, together with his good judgment and wide experience, caused him to be appointed to many other committees of the Association, either as a member or as a chairman, notably, the Speakers Bureau, Finance Committee, Lawyers Reference

Service, Committee on Public Relations, Judicial Campaign Committee, and Committee on Coordination with the State Bar. He attained and held an estimable and honored position in his profession, and was for a period of years the Attorney for Home Owners Loan Corporation, and was a founder of the Motion Picture Relief Association for which he remained counsel until his death.

He leaves with his friends and associates the memory of an honorable and respected citizen, an upright and able lawyer, and a kindly, just, and gracious character.

NOW, THEREFORE, BE IT RESOLVED by the Board of Trustees of the Los Angeles Bar Association that they record their sorrow in the passing of EWELL D. MOORE, and extend their sincere sympathy to the members of his family.

RESOLVED, further, that this Resolution be spread upon the minutes of the Los Angeles Bar Association, and published in the LOS ANGELES BAR BULLETIN, and that a copy be sent to his surviving wife.

THE ATTORNEY AS A TAXPAYER

II

By Irvin Grant*

Irvin Grant

Income From Sale of Law Practice or Goodwill

Can an attorney sell his practice and report any profit made as a capital gain? In a leading case[15] on this point an attorney who had served as a justice for eleven years on the Court of Appeals of Kentucky went back into the private practice of law. A number of years later he formed a law partnership with two other attorneys, and he received from each of his partners the sum of $25,000 for the goodwill brought into the partnership by him. It was held that the $50,000 received by the attorney was not a capital gain upon the sale of goodwill, and the entire amount received was taxable as ordinary income. The court held it questionable whether a professional man could ever sell goodwill except perhaps by the terms of a contract whereby he agreed to refrain from practicing his profession, and, if he had such goodwill, he lost none of it by entering into the partnership. It was further held that the attorney had agreed to take a lesser share of the partnership profits in future years in return for an immediate cash payment, and the payment represented compensation for personal services. A case decided in 1946 involving a firm of public accountants held that a professional partnership ordinarily could have no goodwill or, at most, a nominal value could be ascribed to it.[16]

An indication of a change in attitude on the problem of recognizing goodwill of attorneys as an asset capable of sale was given in 1946 in the case of *John G. Madden*.[17] In that case it was held that where a law partnership recognizes the existence of goodwill and circumstances indicate its presence, goodwill in a law partnership will be considered an asset capable of sale and transfer.

*Of the Los Angeles Bar. For a brief biographical sketch of Mr. Grant, see 26 LOS ANGELES BAR BULLETIN 170 (January, 1951).

[15]E. C. O'Rear, 28 B.T.A. 698 (1933), aff'd, 80 F. 2d 473 (C.C.A. 6th, 1935).

[16]Charles F. Coates, 7 T.C. 125 (1946).

[17]1946 P-H TC Memo. Dec. 46,158.

In 1949 the Tax Court rendered its decision in the case of *Rodney B. Horton*.[18] A certified public accountant sold his practice under an agreement which contained a covenant not to compete for a period of six years. The accountant was paid an amount in excess of the book value of the physical assets transferred. Of the amount received by the accountant which was in excess of the book value of the assets transferred, 50% was held to be attributable to the covenant not to compete and taxable to the recipient as ordinary income, but the other 50% was held attributable to the sale of goodwill and was taxable as a capital gain. The majority opinion did not discuss any of the previous decisions dealing with the sale of goodwill by a professional man, but the dissenting judges relied on the *O'Rear*[19] case holding there was no such goodwill.

The theory of the *Horton* decision has been expanded by two more recent cases. In one case the Tax Court ruled that the sum of $50,000 received by a certified public accountant upon the sale of his accounting practice constituted a capital gain to the vendor.[19a] In the other case an attorney sold his interest in a law partnership. The sales price was set after taking into consideration the interest of the attorney in fees not yet collected both as to work completed and work in progress. In this latter case the entire profit made by the attorney was held to be taxable as a capital gain.[19b]

Income Earned Over 36 or More Months

Attorneys and other persons whose income is derived from personal services may receive or accrue within one year large sums which were earned over a period of many years. Tax relief for this situation was originally extended by Section 220 of the Revenue Act of 1939 which permitted apportionment of income for personal services over the entire period in which the services were rendered provided that the services were rendered over a period of 5 or more calendar years and at least 95% of the total compensation was paid on completion of the services. For tax years starting in 1941 the period was changed to 60 months and the percentage of total compensation received on completion was changed to 75%. Since 1942 this provision, now Section 107 of

[18]13 T.C. 123 (1949).
[19]E. C. O'Rear, 28 B.T.A. 698 (1933), aff'd, 80 F. 2d 473 (C.C.A. 6th, 1935).
[19a]Richard S. Wyler, 14 T.C. No. 142, June 23, 1950.
[19b]Swiren v. Commissioner, 183 F. 2d 656 (C.C.A. 7th, 1950).

(Continued on page 219)

THE LAWYER

By M. L. Hankins*

THE lawyer, like the mother-in-law, is the butt of all jokes. Most of them are based on the theme that the lawyer is dishonest and untrustworthy. The truth is that in all ages the lawyers have been the highest type of citizen. All public officials—guardians, executors, administrators and others—who handle money belonging to other people, are required to give bond—all except lawyers. Every year lawyers handle billions of dollars of other people's money faithfully without bond.

When the city of San Francisco was destroyed by the great earthquake in 1906, the books and records of the Bancroft-Whitney Company, a law publishing firm, were destroyed. The company published in the newspapers an open letter stating that the lawyers of America owed it $300,000, that all records of that indebtedness were lost, but that the money was needed for the firm to stay in business. Thirty-two years later the company published another letter stating that all of that indebtedness had been paid except $20,000, and payments were still being received on that account. Such a record for honesty cannot be matched by any other people in the world.

In every struggle for liberty, justice and right, the lawyer has been in the lead. In 1215 at Runnymede the people of England forced King John to sign a guarantee of their liberties known as Magna Carta. The man who drafted that instrument was a lawyer. Thomas Jefferson, who wrote the Declaration of Independence, was a lawyer. Roger Williams, who founded the Colony of Rhode Island, established the first Baptist church in that colony if not in America, and wrote the first charter of religious liberty in the world, was a lawyer. Sam Houston, who helped declare the Republic of Texas free and independent, and who commanded the Texas army of 800 which defeated Santa Anna's 6,000 in the open field at San Jacinto, was a lawyer. Abraham Lincoln was a

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*Of Shawnee, Oklahoma. Reprinted with permission from the October, 1950, issue of the *Journal of the American Judicature Society*.

lawyer. Mohandas Gandhi of India was a lawyer. Francis Scott Key, who wrote "The Star-Spangled Banner," was a lawyer.

Some of the greatest names in literature have been names of lawyers. Robert Louis Stevenson was a lawyer. Victor Hugo was a lawyer, and a member of the Chamber of Deputies of France when arrested by Louis Napoleon in 1851. Sidney Lanier, the most rhythmical, musical and lyrical poet America has produced, with the possible exception of Edgar Allen Poe, was a lawyer, and practiced in Austin and San Antonio, Texas. He was a confederate soldier and wore the gray, yet eleven years after the war he was selected to write the symphony and direct the music at the Centennial of the Declaration of Independence at Philadelphia.

Three lawyers have been canonized by the Roman Catholic Church as saints. Saint Ives of Brittany and Saint Fidelis of Suabia both were known as "The Advocate of the Poor." Saint Thomas More of England was beheaded by Henry VIII because of his refusal to recognize the divorce of Henry from Catherine of Aragon so that he might marry Ann Boleyn. More lawyers enter the ministry than any other class of people. Rev. W. E. Penn, famous evangelist of a generation ago, was a lawyer before he was a minister. John B. Denton, slain by Indians in defense of early settlers of Texas, and for whom Denton County, Texas, is named, was both a lawyer and a preacher. President James A. Garfield was first a lawyer and then a minister of the Disciples denomination. Russell H. Conwell, one of the most powerful preachers in America, famous for his immortal lecture, "Acres of Diamonds," was a lawyer for ten years before he became a minister.

When Jesus was crucified, there were more than a million people present. Out of that vast multitude, only two men stepped out to claim His body and give it decent burial. They were Nicodemus and Joseph of Arimathea, and both of them were lawyers. In one of the last letters the Apostle Paul wrote from prison, he begged Titus to bring him a lawyer. Paul was in trouble, and he needed a lawyer. Lawyers are the friends of people who are in trouble.

Brothers-In-Law

By George Harnagel, Jr., Associate Editor

George Harnagel, Jr.

UPON the recommendation of its Costs Committee, the **Vancouver** Bar Association has adopted "a suggested Tariff of Minimum Fees for Non-Contentious Matters not covered by Rules of Court" . . .

* * *

The **Pennsylvania** Bar Association which, unlike our State Bar, is a voluntary organization, is sponsoring a "package" plan under which its annual dues of $10 are reduced to $7 where the members of a County Association decide to come into the State Association on a 100% basis.

* * *

The agreement entered into between the **Hennepin County (Minneapolis)** Bar Association and the banks of that community, provides, among other things, that:

1. In advertisements relating to wills and trusts the bank shall clearly indicate the necessity of the services of a lawyer.
2. The banks shall not recommend any particular lawyer or firm.
3. When it appears that a customer of a bank has a will drawn by a lawyer, the bank may discuss its provisions only (a) either with the approval of such lawyer or (b) following the expiration of seven days after mailing a letter to such lawyer inviting him to participate in the discussion.
4. A bank will not suggest that a customer refrain from naming an individual as co-executor or co-trustee.

* * *

Samples from the minimum fee schedule of The State Bar of **South Dakota**: Office work, $50 per day. Court work, $50 to $100, depending on the court. Probate, ordinary services, $100 plus a percentage based on gross value, less mortgages, as follows:

$1,000 to $5,000, 4%
Excess over $5,000, 2½%.

(Continued on page 215)

ATTORNEYS SPEAK A LANGUAGE

By Grace A. Rogers, Official Reporter, Los Angeles County Superior Court

Attorneys speak a language
Essentially their own,
Were it accurately reported
It would make a lawyer groan
To see his
"and-ahs,"
"but-ahs,"
"now-ahs,"
In the written transcript shown.

"NOW-AH, if your Honor please,
AND-AH, I reiterate,
When this evidence is offered—
BUT-AH, perhaps I'd better wait
Until this witness testifies
AND-AH not anticipate.
BUT-AH if you'll review this data
NOW-AH you'll see, I'm sure
That this is res adjudicata
AND-AH res loquitor."

(Continued on page 215)

One may scan the dictionary
And not find these words defined,
But they're almost concomitant
With a legalistic mind.

So don't criticize a transcript with
"That isn't what was said,"
GOOD GOD, of course it isn't!
The reporter used her head.

BROTHERS-IN-LAW

(Continued from page 213)

The **Minneapolis** Bar Association has published, as a public service project, a Jurors Handbook and distributed it to the clerks of court for the use of jurors. It was not long before a considerable public demand for copies developed from editors, school teachers, civic clubs and many others who seem mystified by the juror's function but anxious to learn about it.

* * *

The Committee on Insurance Law of the Association of the Bar of the **City of New York** has compiled a very helpful and comprehensive "reference guide to insurance law." It collects, classifies and comments upon the books, pamphlets, services, and other literature which can be availed of in that branch of the practice.

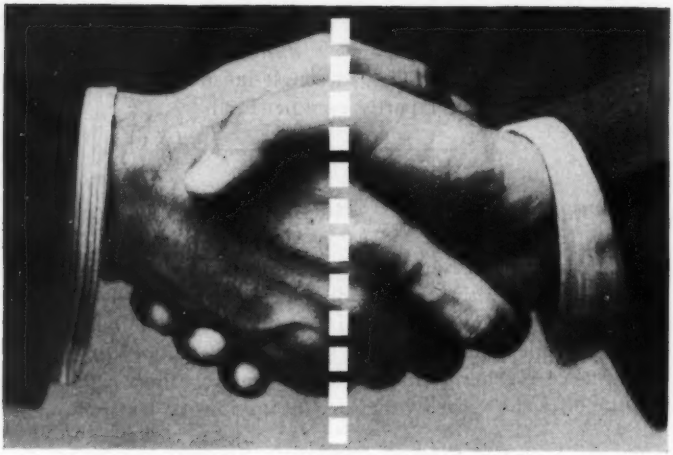
* * *

The **Kentucky** State Bar Association has prepared for radio presentation a series of 13 scripts. Their purpose is to acquaint the public with the function of the lawyer and to discourage resort to unauthorized services of laymen.

The article with the most intriguing title to come across our desk this month: "Can a Spendthrift Escape from Church?" by Christian M. Lauritzen II in the **Chicago** Bar Record. The opening paragraph, which provides a fitting introduction to the article, is as follows:

> "It is characteristic of changes in our tax laws that they plague us with more problems than they solve. A typical example of this hydra-like process is the recent provision for the tax-free release of life estates."

may we complement you?



YOU HAVE	WE HAVE
(a) A PROFESSION	(a) A BUSINESS
(b) CLIENTS	(b) CUSTOMERS
(c) LEGAL KNOWLEDGE	(c) TRUST EXPERIENCE

If, YOU are the attorney, and, WE are the executor/trustee; then, TOGETHER, we can devote our respective talents to the service of the best interests of beneficiaries.

UNION BANK & TRUST CO
of Los Angeles

THE BANK OF PERSONAL SERVICE • MEMBER FEDERAL DEPOSIT INSURANCE CORP. & FEDERAL RESERVE SYSTEM • EIGHTH & HILL • WE HAVE NO BRANCHES

Silver Memories

Compiled from the World Almanac and the L. A. Daily Jonrnal of February, 1926, by A. Stevens Halsted, Jr., Associate Editor.

A. Stevens Halsted, Jr.

FEDERAL Judges **James McCormick** and **Henning** have selected **David B. Head** as United States Commissioner. Head will fill the vacancy caused by the appointment of Commissioner **Raymond J. Turney** to the new Municipal Court bench. Head has been actively engaged in prohibition enforcement work for several years.

* * *

County Counsel **Edward T. Bishop** has announced the appointment of two new members to his staff: former Deputy District Attorney **Pierce Works** and former Deputy Public Defender **McIntyre Faries.**

* * *

The Mexican government has declared the nationalization of all church property and has begun deportation of foreign priests and nuns.

* * *

The U. S. House by a vote of 354 to 28, and the Senate 61 to 11, passed the new tax bill reducing income taxes by $387,000,000.

* * *

The new building of the Law School of the University of Southern California was formally dedicated. **James Brown Scott,** first preceptor of the Law School, and **Mrs. Mabel Walker Willebrandt,** Assistant Attorney General of the United States, were the guests of honor and principal speakers. Other prominent guests included Dean **McMurray** of the University of California, Dean **Kirkwood** of Stanford University, **James G. Mott,** president of the Los Angeles Bar

Association, and Hon. **Charles A. Shurtleff**, president of the California Bar Association.

* * *

Charles E. R. Fulcher has resigned from the County Counsel's office to enter private practice with the firm of **Culver & Nourse.** Fulcher, a graduate of U. S. C. Law School, holds the unique distinction of having been associated with all of the legal departments of the County, serving as deputy district attorney, deputy public defender and until recently as deputy county counsel.

* * *

Col. **"Billy" Mitchell,** former Assistant Chief of the Army Air Service, has been found guilty of insubordination for his critical attacks on the administration of Army and Navy aviation. He has been sentenced to suspension from rank and command, with forfeiture of all pay and allowances for five years. Before the President's Special Air Inquiry Board, Col. Mitchell testified that the United States has only 24 airplanes fit for use and that Great Britain could ship 1,000 planes across the Atlantic and send them into operation against the United States ten days later from Canadian bases. Acting Secretary of War **Davis,** Major-General **Hines,** Chief of Staff, and Brig. Gen. **Hugh A. Drum,** Assistant Chief of Staff, also appeared before the Board and denied that the present Army Air Service is not prepared for battle and further denounced Mitchell's scheme for a unified air force. Davis admitted the service is inadequately equipped, but declared there is no reason to be alarmed over existing conditions. Navy chiefs also testified against any sweeping changes. Secretary **Curtis Wilbur** and Rear Admiral **Edward W. Eberle,** Chief of Naval Operations, vigorously opposed Mitchell's reorganization plan. Mr. Wilbur declared against a department of national defense, and likewise opposed an independent air corps, analogous to the Marine Corps.

* * *

William T. Craig and **Frank C. Weller** recently formed a new law partnership. Mr. Craig is general counsel of the Los Angeles Wholesalers' Board of Trade, and Mr. Weller has been a member of the State Legislature for the last two sessions, recently serving as chairman of the Assembly Judiciary Committee.

ATTORNEY AS A TAXPAYER

(Continued from page 210)

the Internal Revenue Code, requires that personal services be rendered over a period of 36 months or more and that at least 80% of the total compensation be received or accrued in one tax year, and not necessarily upon completion of the services.

Where Section 107 is applicable the compensation received or accrued is spread over the months during which the fee was earned. The tax for prior years must be recomputed so that it may be ascertained what additional tax would have been paid if a proportionate part of the income had been reported in such prior years. The tax payable in the year the income is received or accrued is limited to the additional tax that would have been imposed had the income been reported on an equal monthly basis during the time the work was being performed.

In determining whether the attorney is entitled to the relief accorded by Section 107, one of the most troublesome problems is the determination whether the attorney taxpayer received or accrued within one tax year the necessary percentage of the total fee. A law firm was retained in 1918 by a number of clients to recover upon claims against the German government for shipping losses suffered during World War I. The firm recovered many millions of dollars for its clients with the work continuing through 1931 at which time all assets available for the payment of such claims were exhausted except for a special fund held by the Treasury Department. The firm obtained satisfaction of additional claims out of this special fund, and in 1941 the firm received in excess of $150,000 as compensation for work performed during 1932-1941. The attorneys claimed relief under Section 107 on the ground that the fees received in 1941 were solely for work performed during the 1932-1941 period, while the Commissioner of Internal Revenue contended that Section 107 was not applicable because the fees received in 1941 were not a sufficient percentage of the total fees received in this matter to warrant such relief. It was held that no separation could be made between the fees received prior to 1941 and the fees received in 1941, and the fees received in 1941 as compared to the total fees received since 1918 did not warrant application of Section 107.[20]

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[20] D. Roger Englar, 1947 P-H TC Memo. Dec. 47,197, aff'd, 166 F. 2d 540 (C.C.A. 2d, 1948).

An attorney was retained by the receiver of an insurance company to perform services in connection with the liquidation of the company. The services were rendered over a period slightly in excess of 5 years, and during that period of time the court authorized payments on account of attorneys' fees totaling $36,500. The payments were authorized by the court upon condition that the fees granted in the interim were to be charged against the total fee to be allowed upon conclusion of the case, and the interim fees granted were for services already rendered. In 1942, after the work was completed, the attorney was paid an additional $12,500 in full payment of his fee. Amounts received in prior years were reported by the attorney as income. The attorney claimed that the amounts previously paid to him were advances or loans and that the fee was actually paid in its entirety in 1942. It was held that the sums previously paid over to the attorney were paid over without restriction despite a contingent liability to repay any sums in excess of the total fee ultimately fixed by the court. Such sums were properly reported as income in the year in which they were received. The fee received in 1942 was considered income that year, and Section 107 would not be applicable because the required

percentage of the total fee had not been received in the one year.[21]

In determining whether an attorney is entitled to the relief provisions of Section 107, amounts received by an attorney to reimburse him for costs of suit are not to be considered as income in determining whether the percentage limitation has been met. In the absence of an agreement to the contrary, expenses of a suit are considered those of the client, and moneys received by an attorney for costs are by way of advancement or reimbursement rather than a part of the fee.[22]

An attorney entered into an agreement wherein he was to receive 15% of the recovery plus the unexpended portion of an advancement of $27,500 to cover costs. It soon became evident that a considerable portion of the fund would not be spent for costs, and would be retained by the attorney as part of his fee. During the period 1932-1934 the attorney, with consent of the client, retained for his own use $1,168 received as interest on the money advanced for costs. During the period 1932-1936 the client consented to withdrawals amounting to $5,500 from the funds to be applied against the fee. In 1940 the attorney received $121,788 in payment of his fee. Section 107 at that time provided that at least 95% of the fee had to be received in one year after the services were completed. The Commissioner contended that the attorney had received more than 5% of the total fee prior to 1940 because the $5,500 withdrawn from the funds for costs and the $1,168 received as interest would have to be taken into consideration as payments on the fee, and thus only 94.8% of the total fee had been paid in 1940. It was held, however, that the amount received as interest was no part of the agreed compensation, and for this reason the 95% limitation had been satisfied.[23]

The burden is on the attorney to prove that he is entitled to the benefits of Section 107. Income tax returns for those prior years over which the income is to be spread must be produced, and the taxpayer must have computations to support the proper allocation of tax.[24]

Prior to the amendment of Section 107 by the Revenue Act of 1942, the tax relief granted by that section was available only to

[21] Lloyd C. Whitman, 10 T.C. 151 (1948).
[22] Leland J. Allen, 5 T.C. 1232 (1945).
[23] Hanna v. Commissioner, 156 F. 2d 135 (C.C.A. 9th, 1946), reversing Byron C. Hanna, 1945 P-H TC Memo. Dec. 45,014.
[24] Walter J. Gresham, 1949 P-H TC Memo. Dec. 49,017.

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attorneys who performed services upon a case either as an individual or as a member of a partnership for the required period. Where the services were rendered in part by an individual attorney and in part by a partnership of which he was a member, it was held that other members of the partnership could not avail themselves of Section 107 even though the period of partnership and individual services, when joined, would be sufficient for tax relief.[25]

It is no longer necessary that the individual who includes the compensation in his gross income be the person who rendered the services. Three recent cases[26] involving attorneys illustrate the change made by the Revenue Act of 1942. In one of these cases[27] an established partnership admitted another attorney into membership on January 1, 1941. In 1942 the partnership received a fee for services which extended back to 1935. It was held proper for the attorney who joined the partnership in 1941 to allocate his share of that fee over the entire period during which the services were rendered.

Expenses Incident to Admission to Practice

An attorney is not permitted to deduct expenses incurred in his education either before or after his admission to practice because such expenses are considered personal in nature.[28] State bar examination fees and traveling expenses incurred and paid by a lawyer in securing admission to practice his profession are in the nature of capital expenditures and may not be deducted from gross income.[29]

Bar Association Dues and Assessments

Dues paid by an attorney to a bar association are deductible from gross income.[30] Expenses incurred in attending bar association meetings are also deductible from gross income.[31] Special contributions, however, to a bar association may not be deducted unless it can be shown that the contribution was an ordinary and necessary business expense. Where a bar association appointed a

[25]Ralph G. Lindstrom, 3 T.C. 686 (1944), aff'd, 149 F. 2d 344 (C.C.A. 9th, 1945).
[26]Elder W. Marshall, 14 T.C. 90 (1950); Burnham Enersen, 1950 P-H TC Memo. Dec. 50,024; Sigvald Nielson, 1950 P-H TC Memo. Dec. 50,025.
[27]Elder W. Marshall, 14 T.C. 90 (1950).
[28]I.R.C., Sec. 23; Reg. 111, Sec. 29.23(a)-15.
[29]O.D. 452, C.B. June 1920, p. 157.
[30]Henry P. Keith, 1942 P-H BTA-TC Memo. Dec. 42,630.
[31]Wade H. Ellis, 15 B.T.A. 1075 (1929), aff'd, 50 F. 2d 343 (App. D.C., 1931).

committee to investigate the administration of the bankruptcy laws in the district where the members practiced, a contribution by an attorney of $5,000 was disallowed as a deduction from gross income because there was no evidence to indicate that the contribution was an ordinary and necessary expense of conducting a law practice, nor was it proven that the bar association was organized or operated exclusively for educational purposes so that the contribution could be classed as one to an educational organization.[32] It is interesting to note that the court reached its decision to disallow the deduction even though it admitted that the investigation proved valuable in correcting abuses and improving the administration of the bankruptcy laws. It should be noted, however, that the attorney's gross income for the year from his law practice was only $6,000. On the other hand, a contribution of $2,500 by an attorney to a bar organization which had as its purpose the amendment of the state constitution so as to effect a change in the method of selecting judges was allowed as an ordinary and necessary business expense.[33] The court in the latter case found the expense to be "necessary" because it was "helpful or appropriate" and it was "ordinary" because it is an ordinary thing for lawyers to take active personal and financial interest in movements designed to improve the processes of justice.

The American Bar Association appointed a committee to make a study and submit a report on criminal procedure and law enforcement. To obtain material for this report certain members of the committee went to Europe to study law enforcement in foreign countries as compared with law enforcement in the United States. One attorney spent $2,700 in making the trip, and no part of this expenditure was reimbursed by the American Bar Association. It was held that inasmuch as the trip had no possible connection with the attorney's income for the year in question, it was not deductible as an ordinary and necessary expense.[34]

Political Contributions

Contributions to political organizations are not deductible for income tax purposes.[35] An attorney claimed as a deduction expenditures made to organize political clubs and to elect various officials to office on the ground that it was an ordinary and neces-

[32]Alfred A. Cook, 30 B.T.A. 292 (1934).
[33]3 T.C. 696 (1944).
[34]Wade H. Ellis, 15 B.T.A. 1075 (1929), aff'd, 50 F. 2d 343 (App. D.C., 1931).
[35]I.T. 3276, C.B. 1939-1, p. 108.

sary expense of his law practice. The attorney contended that such contributions developed prestige with elected officials which aided the attorney in furthering the interests of a client which was a public utility corporation. The contention was rejected on the ground that expenditures calculated to exert political influence are contrary to public policy.[36]

Depreciation

The cost of property having a useful life of more than one year may be deducted from gross income by depreciation allowances extending over the useful life of such property. The principal depreciable items used by an attorney in his practice are his office equipment, library, and leasehold improvements.

The Bureau of Internal Revenue has estimated the useful life on items most commonly found in law offices as follows:[37]

Adding machines	10 years
Cabinets and files	15 years
Book cases	20 years
Desks	20 years
Dictation machines	6 years
Library	30 years
Rugs, carpets and mats	10 years
Safes and vaults	50 years
Typewriters	5 years

The estimated useful lives shown above are to be used only as a guide in determining the correct rate of depreciation, and all pertinent data should be considered in establishing the estimated useful life.[38] For example, whether the equipment purchased was new or used would affect the estimated remaining useful life. In the reported cases depreciation rates on office furniture and fixtures have been as low as 5%[39] and as high as 25%.[40]

The cost of professional periodicals and books having a temporary value should be deducted as an expense of doing business, but the cost of volumes having a more permanent value should be capitalized and made the subject of a depreciation allowance.[41]

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[36]Charles H. McGlue, 45 B.T.A. 761 (1941).
[37]Int. Rev. Bur., Bulletin F (1942).
[38]Int. Rev. Bur., Bulletin F (1942).
[39]Union Bleachery v. U.S., 79 F. 2d 549 (C.C.A. 4th, 1935).
[40]LaFrancaise Piece Dye Works, 14 B.T.A. 71 (1928).
[41]Int. Rev. Bur., Bulletin F. (1942).

In one of the very few cases dealing with depreciation of an attorney's library, a depreciation allowance of 5% per year was approved.[42] An attorney was permitted to deduct depreciation on two law libraries, one at his office and one at his home, where it was shown that both libraries were used by the attorney in his practice.[43]

Leasehold improvements are capital expenditures and may be recovered through periodic charges against gross income by way of amortization or depreciation. If the improvements have a useful life which is greater than the unexpired term of the lease, the cost of such improvements may be charged against income in equal annual installments over the remaining term of the lease. If the unexpired term of the lease is greater than the estimated useful life of the leasehold improvements, the deduction takes the form of the ordinary allowance for depreciation.[44]

The allowance for depreciation of furniture of a law office is not limited to those types of furniture commonly recognized as business or office furniture. An attorney furnished an office in his home with very fine and expensive furniture. The Commissioner of Internal Revenue refused to recognize any allowance for depreciation on the ground that the furnishings were too luxurious to be business furniture. It was held that the cost of the furniture affects only the reasonableness of the allowance for depreciation. That part of the cost of the furnishings which was beyond reasonable necessity could not be used as a basis for depreciation because it would have no reasonable relationship to the attorney's business, but it was recognized that the limit of reasonableness is not easy to define.[45] All furnishings actually used as part of the law office are subject to an allowance for depreciation provided it can be shown that the furnishings are subject to depreciation. An attorney was allowed depreciation on the following items used in his law office: rug, radio, drapes and curtains, lamps and shades, cocktail tables, bookcases, steel files, stationery cabinets, desks and benches. No allowance for depreciation could be had as to a grandfather clock and a painting used in the office

[42]Arthur A. Beaudry, 1943 P-H TC Memo. Dec. 43,156, aff'd on this point 150 F. 2d 20 (C.C.A. 2d, 1945).

[43]Arthur A. Beaudry, 1943 P-H TC Memo. Dec. 43,156.

[44]Reg. 111, Sec. 29.23(a)-10.

[45]Arthur A. Beaudry, 1943 P-H TC Memo. Dec. 43,156, aff'd, 150 F. 2d 20 (C.C.A. 2d, 1945).

because it was not shown that these items were subject to "exhaustion wear or tear" or "obsolescence."[46]

Certain property that may have been acquired by an attorney primarily for his personal use may also be used by him in his law practice. No depreciation is allowable on property acquired for personal use, such as a pleasure automobile or a residence, but if such property is used in whole or in part for business or for the production of income, depreciation is allowable on a pro-rata basis. If an attorney uses a portion of his residence for business purposes, he may claim an allowance for depreciation based on the ratio of the total number of rooms in the building as compared to the number of rooms being used for business.[47]

Malpractice Losses and Expenses

Premiums paid by an attorney for malpractice insurance, being a premium on liability insurance connected with his practice of law, are deductible from gross income as an ordinary and necessary expense of doing business.[48] A voluntary payment made by an attorney to his client to compensate for a loss caused by the attorney's negligence is deductible by the attorney as an ordinary and necessary business expense.[49]

Payments made by an attorney to fulfill a moral obligation are not deductible from gross income unless it is shown that there is a reasonable expectancy that future business will result from satisfaction of such obligation. An attorney represented to creditors in a bankruptcy proceeding and to the referee in bankruptcy that funds would be available to carry out a plan of settlement with creditors. The expected funds failed to materialize, and the attorney furnished the money to honor the promises he had made. Such payment by the attorney was held not to be deductible from gross income on the ground that it was not an ordinary and necessary business expense. It was held that if the expenditure was made with a view toward getting future business, it was more a capital outlay for goodwill than an expense of conducting a law

[46]Arthur A. Beaudry, 1943 P-H TC Memo. Dec. 43,156, modified on this point, 150 F. 2d 20 (C.C.A. 2d, 1945).
[47]Int. Rev. Bur., Bulletin F. (1942).
[48]Reg. 111, Sec. 29.23(a)-1.
[49]Edward H. Clark, 40 B.T.A. 333 (1939); Henry F. Cochrane, 23 B.T.A. 202 (1931).

practice.[50] In an analogous situation an attorney receiving a large volume of business from a bank was instrumental in having the bank advance considerable sums of money to a corporation owned and controlled by members of the attorney's family. Payment by the attorney to the bank of the difference between what the bank received from the bankrupt estate of the corporation and the amount loaned was held deductible by the attorney as a business loan. It was stressed that the attorney in this case could not afford the ill-will of the bank and that the payment was made primarily to protect the attorney's business with the bank.[51]

Publications

The subscription price paid by attorney for publications related to the practice of his profession is deductible as a business expense.[52] An attorney was denied a deduction for the cost of certain publications because it could not be shown that they were related to the practice of law, or, if so related, that they had such a short useful life so as to be deductible as an expense. Among the items disallowed were: subscriptions to National Geographic Magazine, National Jewish Ledger, Contemporary Jewish Record and Washington Law Reporter, the Annual Federal Digest for 1939, and the United States Digest Court Rules. The cost of a photograph of the members of the United States Supreme Court was disallowed as an expense.[53]

Associate Fees

Amounts paid to associate attorneys are deductible as an ordinary and necessary business expense provided sums so paid are included in gross income.[54] An attorney is entitled to this deduction even where no cash is paid over, *e.g.*, where the amounts earned by the associate attorney are credited against a prior indebtedness.[55] However, an attorney receiving a fee subject to a fee sharing agreement with an associate need include in gross income only that portion of the fee in which he has a beneficial interest. The failure to pay over the associate's share of the fee prior to the end of the tax year does not affect this rule. That

[50]Friedman v. Delaney, 75 F. Supp. 568 (D.C., D. Mass., 1948), aff'd on this point, 171 F. 2d 269 (C.C.A. 1st, 1948).

[51]Frank B. Ingersoll, 7 T.C. 34 (1946).

[52]Charles E. Kelly, 1932 P-H BTA Memo. Dec. 32,066; O.D. 785, C.B. June 1921, p. 130.

[53]Julius I. Peyser, 1943 P-H TC Memo. Dec. 43,138.

[54]Mark M. Horblit, 1943 P-H TC Memo. Dec. 43,012.

[55]Mark M. Horblit, 1943 P-H TC Memo. Dec. 43,012.

portion of the fee payable to the associate attorney is held in trust for the associate.[56]

Disbarment Proceedings

At one time the Bureau of Internal Revenue maintained the position that the expenses of an attorney in defending disbarment proceedings were not deductible as a business expense on the ground that such proceedings are quasi-criminal in nature and would be governed by the principles applicable to expenses incurred in defending criminal matters.[57] A later ruling allowed a deduction for such expenses.[58] In 1941 the Court of Appeals for the Seventh Circuit held that the expenses incurred by an attorney in an unsuccessful effort to expunge from the record an order suspending him from practice before the Treasury Department were not deductible on the ground that such expenses were extraordinary and personal.[59] As a result of this decision the Treasury Department modified its position so as to distinguish between those cases in which the attorney was successful in defending disbarment proceedings and those in which he was unsuccessful. Expenses incurred in a successful defense of disbarment proceedings are now deductible as an ordinary and necessary business expense.[60]

Rent

Rent paid by an attorney for office space used in practicing his profession is deductible as an ordinary and necessary business expense.[61] Where an attorney rents a house for residential purposes and in the course of his practice incidentally receives clients at his home, no part of the rent paid is deductible as a business expense. If a portion of the home is also used as an office, such portion of the rent as is properly attributable to the office is deductible.[62] If the property is rented primarily for use as a residence, the basis of apportionment between business and personal uses should be on the basis of the number of rooms devoted to each

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[56]Mark D. Eagleton, 35 B.T.A. 551 (1937), aff'd, 97 F. 2d 62 (C.C.A. 8th, 1938).

[57]I.T. 2168, C.B. June 1925, p. 140.

[58]I.T. 2252, C.B. June 1926, p. 227.

[59]Paysoff Tinkoff, 1938 P-H BTA Memo. Dec. 38,295, aff'd, 120 F. 2d 564 (C.C.A. 7th, 1941).

[60]I.T. 3583, C.B. Dec. 1942, p. 189; Louise S. Levy, 1942 P-H BTA-TC Memo. Dec. 42,645.

[61]R. Shad Bennett, 1942 P-H BTA-TC Memo. Dec. 42,576; aff'd on this point, 139 F. 2d 961 (C.C.A. 8th, 1944).

[62]Reg. 111, Sec. 29.24-1.

use. If the premises have been rented primarily as office space, the rental value of the living quarters should be estimated, and the difference between the entire rental paid and the value of the premises as living quarters is deductible as an ordinary and necessary business expense.

Traveling Expenses

Traveling expenses incurred by an attorney in his practice are deductible from gross income.[63] Expenses incurred by an attorney in traveling from his place of residence to his place of work are not deductible from gross income because such expenses are considered to be personal in nature.[64] An attorney using an automobile partially for personal use and partially for use in connection with his practice of law, can deduct that portion of car expense allocable to business use.[65]

The leading case[66] on traveling expenses involved an attorney residing in Jackson, Mississippi, who became counsel for a railroad which had its main office in Mobile, Alabama. Because the attorney refused to accept the position if he were required to move to Mobile, an arrangement was made whereby the attorney could continue to live in Jackson. The attorney was required to pay his travel expenses between Jackson and Mobile as well as his living expenses in both places. In holding that the attorney could not deduct the cost of travel between Jackson and Mobile nor the expense of meals and lodging in Mobile, the following tests were laid down to determine the deductibility of travel expenses: (1) The expense must be a reasonable and necessary traveling expense, as that term is generally understood, and includes transportation fares, food, and lodging expenses while traveling; (2) The expense must be incurred while away from home; (3) The expense must be incurred in pursuit of business, that is, there must be a direct connection between the expenditure and the carrying on of the taxpayer's trade or business. All three tests must be satisfied to obtain a deduction for traveling expenses.

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[63]Reg. 111, Sec. 29.23(a)-2.

[64]Commissioner v. Flowers, 326 U.S. 465 (1946); George F. Thompson, 6 T.C. 285 (1946), aff'd, 161 F. 2d 185 (C.C.A. 2d, 1947); E. C. O'Rear, 28 B.T.A. 698 (1933); aff'd, 80 F. 2d 473 (C.C.A. 6th, 1935); Frank H. Sullivan, 1 B.T.A. 93 (1924).

[65]Lewis F. Jacobson, 6 T.C. 1048 (1946), rev'd on another point, 336 U.S. 28 (1949); Charles H. Sachs, 6 B.T.A. 68 (1927); Julius I. Peyser, 1943 P-H TC Memo. Dec. 43,138.

[66]Commissioner v. Flowers, 326 U.S. 465 (1946).

Where the sole occupation of the taxpayer was that of Justice of the Supreme Court of North Carolina, and state law required all sessions of the court to be held at the state capital, it was held that the expenses incurred by the justice in traveling from his home to the state capital to perform his duties as justice were personal.[67] The court recognized, but refused to give effect to, an unwritten law that the justices were to be chosen from all parts of the state. It was intimated, however, that the result would be different if the justices were required by law to maintain residences in different parts of the state.

An attorney residing and practicing in Wilkes-Barre, Pennsylvania, accepted a position as Secretary of the Commonwealth of Pennsylvania, and her duties in this office required her presence at Harrisburg, the state capital, which was located in another county. The local rules of court provided that an attorney who ceased to reside in the county and to practice there for one continuous year would be deemed to have abandoned his privileges to the bar, and his name would be stricken from the rolls. The attorney maintained a residence in Wilkes-Barre and she returned to this residence on week-ends. A considerable amount of time was devoted on week-ends by the attorney to her law practice, and on occasion she would return during the middle of the week to attend to some matter incident to her practice of law in Wilkes-Barre. The attorney reported a relatively small income from her private law practice during the years in question. Deductions claimed for rent, electricity, gas, coal, water and maid service in connection with her apartment in Harrisburg, the state capital, were disallowed. It was held that the attorney had but one principal place of business which was in the state capital, and living expenses there were personal living expenses.[68] On the other hand, an attorney practicing law in Toledo, Ohio, accepted the chairmanship of a Congressional Joint Committee on Reorganization of Executive Departments with the understanding that the work would not require him to give up his law practice, and it was held that travel expenses between Washington, D. C., and Toledo, Ohio, together with necessary lodging and meals in Washington were

[67] Barnhill v. Commissioner, 148 F. 2d 913 (C.C.A. 4th, 1945).
[68] S. M. R. O'Hara, 6 T.C. 841 (1946).

proper deductions from gross income because during this period the attorney was considered to have had two businesses.[69]

The following traveling expenses of attorneys have been allowed:

a. Transportation fares[70]
b. Meals and lodging away from home[71]
c. Repairs to automobile[72]
d. Parking space for car (at office)[73]
e. Insurance on car[74]
f. Washing of car[75]
g. Greasing of car[76]
h. Automobile hire[77]
i. Travel between office and courts[78]

Entertainment Expenses

Entertainment expenses can be deducted from gross income if it can be shown that they are ordinary and necessary business expenses. The cost of meals and entertainment for witnesses during the course of trial or preparation for trial is a deductibe item.[79] Sums spent by an attorney to entertain his clients are deductible.[80]

Where an attorney desires to deduct expenses of a social nature, he must have proof that such expenditures had a direct relation to the conduct of his business or the business benefits expected from such expenditures.[81]

Dues paid by an attorney for membership in social clubs, country clubs, and similar organizations are generally not deductible from

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[69]Walter F. Brown, 13 B.T.A. 832 (1928).

[70]Walter F. Brown, 13 B.T.A. 832 (1928); Hamilton Ward, 8 B.T.A. 704 (1927).

[71]Walter F. Brown, 13 B.T.A. 832 (1928); Earl King, 9 B.T.A. 502 (1927); Hamilton Ward, 8 B.T.A. 704 (1927).

[72]Julius I. Peyser, 1943 P-H TC Memo. Dec. 43,138.

[73]Julius I. Peyser, 1943 P-H TC Memo. Dec. 43,138.

[74]Julius I. Peyser, 1943 P-H TC Memo. Dec. 43,138.

[75]Julius I. Peyser, 1943 P-H TC Memo. Dec. 43,138.

[76]Julius I. Peyser, 1943 P-H TC Memo. Dec. 43,138.

[77]Hamilotn Ward, 8 B.T.A. 704 (1927).

[78]George S. Lavin, 1944 P-H TC Memo. Dec. 44,081; Arthur A. Beaudry, 1943 P-H TC Memo. Dec. 43,156.

[79]George S. Lavin, 1944 P-H TC Memo. Dec. 44,081.

[80]Lewis F. Jacobson, 6 T.C. 1048 (1946), rev'd on another point, 336 U.S. 28 (1949); Earl King, 9 B.T.A. 502 (1927); Clyde A. Armstrong, 1947 P-H TC Memo. Dec. 47,245.

[81]Louis Boehm, 35 B.T.A. 1106 (1937); Orville J. Taylor, 1939 P-H BTA Memo. Dec. 39,534, aff'd, 117 F. 2d 189 (C.C.A. 7th, 1941).

gross income because they are personal expenditures.[82] Where it can be shown, however, that such organizations were joined for business purposes, the dues paid can be partially or wholly deducted as business expenses.[83] The proof of a business purpose in the use of such social organizations must be clear,[84] and such proof can be supplied by records of clients secured by membership in the social or country clubs and the fees earned from such clients.[85] An attorney was allowed a deduction for dues paid to a social club used for the purpose of entertaining clients even though no effort was made to use the facilities of the club to obtain new clients.[86] A deduction may be had by an attorney for house bills incurred at a social club or country club.[87]

The initiation fee paid to join a social club is not deductible as a business expense, and such fee must be treated as a capital expenditure.[88] Although the excise tax imposed by Section 1710 of the Internal Revenue Code on club dues and initiation fees is not deductible in computing net income,[89] the tax may be taken as a deduction as a trade or business expense under Section 23(a) of the Internal Revenue Code.[90]

In the usual situation the attorney uses club facilities partially for business purposes and partially for personal enjoyment, and he will be permitted to deduct as a business expense only that portion of his club dues attributable to his business use of the club facilities. Although it has been held that an attorney could deduct the entire amount expended for golf club dues and other club expenses on the basis of his uncontradicted testimony that he did not enjoy playing golf and that he was interested in his golf club only for business reasons,[91] it is doubtful that a deduction of the full amount paid will be allowed under ordinary circumstances.[92]

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[82] I.R.C., Sec. 24(a)(1).
[83] Johnson v. U.S., 45 F. Supp. 377 (D.C., S.D. Cal, 1941), rev'd on another point, 135 F. 2d 125 (C.C.A. 9th, 1943).
[84] S Charles Lee, 1946 P-H TC Memo. Dec. 46,079; Orville J. Taylor, 1939 P-H BTA Memo. Dec. 39,534, aff'd, 117 F. 2d 189 (C.C.A. 7th, 1941).
[85] Johnson v. U.S., 45 F. Supp. 377 (D.C., S.D. Cal., 1941), rev'd on another point, 135 F. 2d 125 (C.C.A. 9th, 1943); S Charles Lee, 1946 P-H TC Memo Dec 46,079
[86] Earl King, 9 B.T.A. 502 (1927); Clyde A. Armstrong, 1947 P-H TC Memo. Dec. 47,245.
[87] Clyde A. Armstrong, 1947 P-H TC Memo. Dec. 47,245.
[88] See Clyde A. Armstrong, 1947 P-H TC Memo. Dec. 47,245; Orville J. Taylor, 1939 P-H BTA Memo. Dec. 39,534, aff'd, 117 F. 2d 189 (C.C.A. 7th, 1941).
[89] I.R.C., Sec. 23(c)(1)(F).
[90] Clyde A. Armstrong, 1947 P-H TC Memo. Dec. 47,245.
[91] Johnson v. U.S., 45 F. Supp. 377 (D.C., S.D. Cal., 1941), rev'd on another point, 135 F. 2d 125 (C.C.A. 9th, 1943). The District Judge made the following comment: "The Government demanded and received large income taxes on the fees collected by the plaintiff as a direct result of plaintiff's expenditure in club dues, and the Government cannot refuse to allow plaintiff a deduction as a business expense of the money which produced the business To rule otherwise would revive the fable of the goose and the golden egg."
[92] *Cf.* S. Charles Lee, 1946 P-H TC Memo. Dec. 46,079.

Estimated Expenses

The taxpayer has the burden of proving all deductions claimed, and he must furnish proof which is as definite and certain as is reasonably possible. If the taxpayer can prove only that an expense has been incurred but is unable to prove the exact amount of the expense, a reasonable estimate of the amount spent will be allowed as a deduction.[93] Among the expenses allowed to attorneys on an estimated basis have been the following: taxi fares spent in going to and from court,[94] entertainment of clients and witnesses during the course of trial,[95] secretarial expenses,[95a] printing,[96] flowers sent to clients,[97] and club expenses.[98]

Accounting Methods

Whether an attorney is on a cash receipts and disbursements basis or on the accrual basis depends upon the manner in which he keeps his records unless the manner of keeping records does not correctly reflect the income of the attorney.[99]

Most attorneys keep their records and report their income on the cash receipts and disbursements basis, but if the records of an attorney are kept on the accrual basis, the Commissioner of Internal Revenue may properly use the accrual basis in determining tax liability.[100] A law partnership may keep its records and report its income on the accrual basis, and the individual members of the firm may report their income on the cash receipts and disbursements basis. In this situation the attorney is required to report his distributable share of partnership income computed on the accrual basis even though the income is not paid over to him during the tax year.[101]

Contingent fees earned by an attorney on the accrual basis should be reported as income during the year the litigation is successfully concluded, but an attorney on the cash receipts and disbursements

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[93]Cohan v. Commissioner, 39 F. 2d 540 (C. C. A. 2d, 1930).
[94]George S. Lavin, 1944 P-H TC Memo. Dec. 44,081.
[95]George S. Lavin, 1944 P-H TC Memo. Dec. 44,081.
[95a]Irvine F. Belser, 10 T.C. 1031 (1948), aff'd, 174 F. 2d 386 (C.C.A. 4th, 1949).
[96]Irvine F. Belser ,10 T.C. 1031 (1948), aff'd, 174 F. 2d 386 (C.C.A. 4th, 1949).
[97]Walter E. Godfrey, 1950 P-H TC Memo. Dec. 50,094.
[98]Walter E. Godfrey, 1950 P-H TC Memo. Dec. 50.094.
[99]Franklin G. Manley, 1942 P-H BTA-TC Memo. Dec. 42,512.
[100]Alfred J. Grosso, 1941 P-H BTA Memo. Dec. 41,581.
[101]Percival H. Truman, 3 B.T.A. 386 (1926); Truman v. U.S., 4 F. Supp. 447 (D.C., N.D. Ill., 1933)

basis would report such a fee as income in the year the fee was paid over to him.[102]

Nonreimbursable expenses paid by an attorney on the cash receipts and disbursements basis in connection with a case where the fee is contingent on the result achieved are deductible in the year the expenditures are made and cannot be deferred until such time as the fee is earned.[103] When a check is given in payment of an expense prior to the close of the tax year but the check is not cashed until after the close of the tax year, the disbursement is considered to relate back to the time the check was issued.[104] If the check is not cashed by agreement, or it can be shown that the attorney never had a sufficiently large bank balance to have honored the check prior to the close of the tax year, the deduction will not be allowed in the year the check was issued.[105]

Where an attorney on the cash receipts and disbursements basis earns a fee which is to be shared with an associate and the fee is received by the associate, the attorney's share of such fee must be reported as income in the year that the fee is received by the associate even though the division of the fee is not effected until a subsequent tax year.[106] The fee is deemed to have been constructively received by the attorney unless it can be shown that he could not have demanded and received his share of the fee in the tax year it was received by his associate.[107]

If a bona fide dispute arises between associate attorneys reporting their income on the cash receipts and disbursements basis as to the division of a fee after one of them has received it, the attorneys need report as income in the year of receipt only that portion of the fee as to which there is no controversy.[108]

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[102]Leland J. Allen, 5 T.C. 1232 (1945); Henry Escher, 1934 P-H BTA Memo. Dec. 34,261, aff'd, 78 F. 2d 815 (C.C.A. 3d, 1935).

[103]Irvine F. Belser, 10 T.C. 1031 (1948), aff'd, 174 F. 2d 386 (C.C.A. 4th, 1949).

[104]Mark D. Eagleton, 35 B.T.A. 551 (1937), aff'd, 97 F. 2d 62 (C.C.A. 8th, 1948); James M. Butler, 19 B.T.A. 718 (1930).

[105]Mark D. Eagleton, 35 B.T.A. 551 (1937), aff'd, 97 F. 2d 62 (C.C.A. 8th, 1948).

[106]Charles H. McGlue, 45 B.T.A. 761 (1941); Mark D. Eagleton, 35 B.T.A. 551 (1930).

[107]Charles H. McGlue, 45 B.T.A. 761 (1941).

[108]Sara R. Preston, 35 B.T.A. 312 (1937).

An attorney on the cash receipts and disbursements basis must include as income in the year of receipt all fees actually or constructively received even though such fees are applicable to work to be performed in future years.[109] If the attorney is obligated to hold in trust the fee received for future work until the fee is earned, such fee is taxable as income of the period in which the attorney has completed all requirements to earn the fee.[110]

The fair market value of property received for professional services is to be reported in the year in which the property is received, and taxation of such income cannot be deferred until such time as the property is sold.[111] An exception is recognized where the property cannot be valued at the time it is received.[112]

Sums received by an attorney as an advance for costs of suit are not income to the attorney.[113] In the event the attorney is authorized to retain as a part of his fee the unexpended portion of the funds advanced for costs, the unexpended funds become income to the attorney in the year the funds are no longer subject to restriction as to use.[114]

Conclusion

The material set forth in this article has been compiled largely from cases involving attorney taxpayers. It should be noted that problems of attorney taxpayers are shared to a certain extent with persons engaged in other professions and persons engaged in selling personal services. By familiarity with the income tax rulings of the courts and administrative agencies the attorney taxpayer is in a better position to avail himself of all possible tax benefits in preparing his income tax return.

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[109]George E. Allen, 1939 P-H BTA Memo. Dec. 39,131, aff'd, 107 F. 2d 151 (C.C.A. 4th, 1939).

[110]H. L. Mulliner, 1939 P-H BTA Memo. Dec. 39,165.

[111]George E. Allen, 1939 P-H BTA Memo. Dec. 39,131, aff'd, 107 F. 2d 151 (C.C.A. 4th, 1939).

[112]T.B.R. 57, C.B. 1919, p. 40.

[113]Henry F. Cochrane, 23 B.T.A. 202 (1931).

[114]Hanna v. Commissioner, 156 F. 2d 135 (C.C.A. 9th, 1946).

COMMUNITY OIL AND GAS LEASES.

(Continued from page 206)

(1) No conveyance of any royalty interests as between lessors is contemplated or effected in a community oil and gas lease.

(2) No royalty interests in gross are created therein.

(3) A surrender of the entire lease by the lessee terminates all interests of all parties thereto.

With regard to the statement of the court in the Moon case, relating to the necessity of joint action on the part of the community lessors to declare a forfeiture, we suggest that:

(1) The lessor of a separately owned parcel in a community lease should have the right to cancel the lease as to his land for any breach of the lease which renders a forfeiture optional.

(2) He should not be required, in order so to terminate the lease as to his land, to secure the joinder of all, or any, of his colessors in a declaration of forfeiture of the entire leasehold.

(3) A waiver of lessee's breach by one lessor should not be deemed a waiver by other lessors of their rights with respect to their respective parcels.

We define "oil royalty" as any portion of the right to oil produced which has become separated from the right to drill for and produce oil.

By entering into a community oil and gas lease each landowner creates and transfers to the common lessee a profit *a prendre*—a right to drill for and produce oil—on his respective land. He also transfers to the common lessee all of his right to retain as his property all oil brought to the surface of his land. As consideration to each landowner for the transfer of these rights to the lessee, the lessee transfers to each landowner the right to a specified share of all of the oil produced by the lessee on all of the lands embraced in the community lease.

In the ordinary oil and gas lease the landowner does not transfer to his lessee his right to all oil produced from his land; he retains a share of oil produced as consideration for creating and transferring to his lessee the profit *a prendre*—the right to drill for and produce oil.

The distinction between the ordinary oil and gas lease and a community oil and gas lease is that under the former the landowner transfers to his lessee only part of his right to oil produced from his land and retains part, whereas under the latter each landowner transfers to the common lessee all of his right to oil produced from his land and receives from the common lessee in return a part of all oil produced on all of the lands embraced in the community lease.

In other words, under an ordinary lease a royalty is retained by the landowner in his land, while under a community lease no separate or distinguishable royalty is retained by a landowner in his land but in lieu thereof a share of royalty in all of the lands is transferred by the common lessee to each landowner.

If this is a true analysis of the nature of the royalty interest created under a community oil and gas lease, then:

(1) No royalty interests are transferred as between lessors; the only royalty interest transferred is from the lessee to each lessor.

(2) Only one kind of royalty interest is created. This royalty interest is in all of the lands as a unit, including each lessor's parcel, and no separate royalty interest is retained by any lessor in his respective parcel.

(3) Each lessor acquires from the lessee a royalty in all of the lands embraced in the lease.

(4) This royalty interest in all of the lands, because it is the consideration for the transfer to the lessee by each lessor of all of his oil rights in his particular land, is appurtenant to each respective parcel and is not created in gross, and a conveyance of the fee by a landowner carries the royalty interest with it.

(5) No royalty interests in gross are created, although by subsequent transfer separately from the land the royalty interests would then become in gross.

(6) A surrender of the entire lease clearly terminates all interests of all parties thereto.

The lease in the Tanner case contained a provision that the lessors "agree to, and they do hereby pool their interests in this lease, and agree that during the continuance of this lease each owner of land subject thereto shall share in all benefits accruing to the whole lease in the ratio which the acreage owned by said Lessors bears to the entire acreage leased." It may be that the courts may justify the Tanner holding as to conveyances of royalty interests as between lessors by virtue of the agreement of the lessors to "pool their interests" in the lease, and hold, with respect to a community lease which does not contain such a provision, that no royalty interests are conveyed as between lessors. However, this provision does not appear to add anything to the lease nor to change the nature of royalty interest created thereby. It appears merely to affirm lessors' understanding that a part of the royalty interest in all of the lands is transferred by the lessee to each lessor in the proportion which his land bears to the total lands.

With respect to the effect of a surrender of a lease, it may be that even under the Tanner holding the courts will hold that

such surrender operates to terminate the alleged conveyances among the lessors, upon the authority of La Laguna Ranch Co. v. Dodge, 18 Cal. (2d) 132. However, until this point is adjudicated a doubt exists, and the only safe course for a landowner would be to secure quitclaims from all other lessors.

Coming now to the statement in the Moon case. It means that upon lessee's breach of the lease for which a forfeiture may be declared under the terms of the lease, no individual lessor can exercise the right of forfeiture either as to his parcel or as to the entire leasehold, but that all lessors must join in the exercise of this right as to the entire leasehold, and the failure for any reason to secure the joinder of all lessors prevents the exercise of the right and permits the lessee to continue to hold all of the leasehold and perform none of his obligations under the lease.

It seems clear that one lessor should not be able to declare a forfeiture of the lease as to all of the lands, but it does not appear to follow that he should not be able to declare a forfeiture as to his own land.

Where an ordinary lease is entered into on one parcel of land by several owners of undivided interests therein, the obligation of the lessee appears to run only to the lessors jointly, and joint action is required by all lessors to exercise the right of forfeiture. But where separate owners of separate parcels enter into a community lease, the obligations of the lessee would appear to run not only to all of the lessors jointly as to the entire leasehold but also to each of the lessors severally as to his particular parcel—in other words, to constitute both joint and several duties. Each lessor should have the right, with respect to his separately owned parcel, to hold the lessee to the latter's obligations under the lease, and to declare a forfeiture of the lease, as to his land, upon lessee's failure to perform. A waiver by one lessor should not be deemed a waiver of all; the lessee should be permitted to continue to hold the parcels only of those lessors who do not seek to exercise their rights.

In view of the rules set forth in the Tanner and Moon cases, landowners may well find they are getting into more than they bargained for in a community oil and gas lease unless the problems discussed herein are resolved by specific provisions in the lease itself.